

The Small Preference Exception of Bankruptcy Code Section 547(c)(7)

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I. INTRODUCTION

The Bankruptcy Code provides the debtor and the bankruptcy trustee with several devices for recovering property transferred by the debtor. One of these devices is section 547,¹ which allows the trustee to “avoid,” or recover, “preferences,” which are certain transfers that benefit one creditor to the detriment of other creditors.² The debtor “prefers” one creditor over another when the debtor pays one creditor before paying the other. Preferences are generally permitted outside of bankruptcy; preference law is concerned only with relationships among creditors within proceedings such as bankruptcy, in which creditors’ rights must be addressed collectively.³ Within bankruptcy, a transfer is a preference if it satisfies all the requirements of section 547(b),⁴ subject to the seven exceptions of section 547(c).

The small preference exception, section 547(c)(7), states:

The trustee may not avoid under this section a transfer if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$600.⁵

* The author is grateful to Professor Nancy Rapoport for her comments on an earlier draft of this Note.

¹ 11 U.S.C. § 547 (1988). All references to section numbers in this Note are to Title 11 of the United States Code.

² See generally Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713 (1985).

³ THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 123–24 (1986).

⁴ Section 547(b) provides that the trustee may avoid any transfer of an interest of the debtor in property if the transfer meets all five of these requirements: the transfer (1) was for the benefit of a creditor; (2) was on account of an antecedent debt; (3) was made while the debtor was insolvent; (4) was made within the applicable preference period; and (5) enabled the creditor to receive more than the creditor would receive in a Chapter 7 case. 11 U.S.C. § 547(b) (1988).

⁵ 11 U.S.C. § 547(c)(7) (1988). Section 547(c)(7) would be renumbered (c)(8) under S. 540, 103d Cong., 1st Sess. § 303(d)(2).

Section 547(c)(7) was enacted by the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA).⁶ The difficulty in analyzing section 547(c)(7) is due in part to the fact that Congress passed the BAFJA in haste, needing to enact jurisdictional legislation in the wake of the Supreme Court's 1982 holding in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*⁷ that the grant of jurisdiction to the bankruptcy courts by the Bankruptcy Act of 1978 was unconstitutional.⁸ There were no congressional hearings on BAFJA, no House or Senate report, nor a joint explanatory statement in the conference report.⁹ However, small preference exceptions had been considered by Congress well before 1984, and it is these earlier proposals to which one must turn to analyze section 547(c)(7).

This Note addresses the issues raised by Bankruptcy Code section 547(c)(7), the small preference exception. Part II examines the rationales for section 547(c)(7). Part III examines the proposals presented to Congress prior to the adoption of the Bankruptcy Act of 1978 and the enactment of section 547(c)(7) in 1984. Part IV examines the courts' construction of section 547(c)(7) and criticisms of section 547(c)(7).

II. THE POLICIES OF PREFERENCE LAW AND THE RATIONALES FOR SECTION 547(C)(7)

It is generally accepted that the preference statute in the Bankruptcy Code has two purposes. The primary purpose is to promote equality in the distribution of the debtor's assets to the creditors.¹⁰ The secondary purpose is to prevent creditors from pressuring debtors on the verge of bankruptcy into making payments.¹¹ Ideally, then, the preference exceptions provided in section 547(c) would protect only those transfers that fall within the section 547(b)

⁶ Pub. L. No. 98-353, § 310(3), 98 Stat. 333, 378 (1984).

⁷ 458 U.S. 50, 87 (1982) (plurality opinion).

⁸ Lissa Lamkin Broome, *Payments on Long-Term Debt as Voidable Preferences: The Impact of the 1984 Bankruptcy Amendments*, 1987 DUKE L.J. 78, 79 n.11, 88, 109 & n.143 (1987); 130 CONG. REC. 6284-85 (statement of Rep. Gingrich, criticizing the expeditious processing of the bill and the degree to which it was influenced by lobbyists).

⁹ 1984 U.S.C.C.A.N. 576, 576 (caption).

¹⁰ This has also been called the primary purpose of the bankruptcy system generally. H.R. REP. NO. 595, 95th Cong., 1st Sess. 177-78 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6138; Jeffrey W. Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 WM. & MARY L. REV. 91, 115 (1985); Broome, *supra* note 8, at 113 & n.168.

¹¹ H.R. REP. NO. 595, *supra* note 10, at 177, reprinted in 1978 U.S.C.C.A.N. at 6138; Morris, *supra* note 10, at 115; Broome, *supra* note 8, at 115.

definition of a preference, but whose avoidance contributes nothing to these two goals.

Three rationales for a small preference exception, and for section 547(c)(7) in particular, have been advanced, but all have been criticized for failing to promote either of the goals of preference law. The first two rationales are based on the notion that the addition of section 547(c)(7) in 1984 was part of Congress's response to consumer lenders' complaints that the Bankruptcy Reform Act of 1978 took away too many protections for creditors.¹² The first rationale is that section 547(c)(7) served to counter the effect of the elimination of the "reasonable cause to believe" requirement for preferences.¹³ Prior to the 1978 Bankruptcy Act, one of the requirements of a preference was that, at the time of the transfer, the creditor had reasonable cause to believe that the debtor was insolvent.¹⁴ This requirement was criticized for three reasons: (1) the transferee's state of mind is irrelevant when the issue is promoting the equal distribution policy;¹⁵ (2) some considered the reasonable cause to believe requirement to be excessively protective of creditors because trustees had a difficult time meeting the burden of proof;¹⁶ and (3) some believed the reasonable cause to believe requirement spawned too much litigation.¹⁷ The reasonable cause to believe requirement was eliminated by the 1978 Act, but by 1982 consumer lenders had convinced the Senate Judiciary Committee that the trustee now had too much power to avoid preferences.¹⁸ Thus, the addition of section 547(c)(7) can be seen as Congress's attempt to balance the competing interests of the trustee and the good-faith preference transferee.

However successful section 547(c)(7) is at "balancing interests," such a motive is inconsistent with the two policies of preference law: equality of distribution among creditors and discouraging creditors from pressuring

¹² See Morris, *supra* note 10, at 94-95.

¹³ Broome, *supra* note 8, at 111. The "reasonable cause to believe" requirement was eliminated as to non-insiders in 1978 and completely eliminated in 1984. *Id.* at 95-96 & n.90.

¹⁴ 11 U.S.C. § 96(b) (1976) (repealed 1978).

¹⁵ Broome, *supra* note 8, at 94; H.R. REP. NO. 595, *supra* note 10, at 178, *reprinted in* 1978 U.S.C.C.A.N. at 6138.

¹⁶ Broome, *supra* note 8, at 93-94; H.R. REP. NO. 595, *supra* note 10, at 178-79 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6139.

¹⁷ Broome, *supra* note 8, at 93 & n.80; H.R. REP. NO. 595, *supra* note 10, at 178 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6139.

¹⁸ In 1982, the Senate Judiciary Committee recommended passage of Senate Bill 2000, which would have reinstated the reasonable cause to believe requirement: "The committee recognizes the severe problems that have arisen with preferences, and feels that the burden has been shifted too far and now unfairly discriminates against the good faith creditor." S. REP. NO. 446, 97th Cong., 2d Sess. 23, 24 (1982).

debtors. It is the nature of preference avoidance that the transferee is harmed for the sake of equal distribution among creditors as a class. To rationalize section 547(c)(7) as a pro-creditor "balancing of interests" is to say that section 547(c)(7) is more the result of lobbying by consumer lenders than it is a tool for advancing bankruptcy policy.¹⁹

The second rationale advanced for section 547(c)(7), and the second way in which its enactment responded to the complaints of consumer lenders, is that section 547(c)(7) serves as an adjunct to the section 547(c)(2) "ordinary course of business" exception. To the extent that there might be uncertainty as to whether section 547(c)(2) applies to a particular consumer debt, section 547(c)(7) protects creditors receiving small preferences. "The addition of section 547(c)(7) effectively eliminates, in the case of most consumer payments, the necessity of determining whether the debt was incurred and payment made in the ordinary course of the financial affairs of the consumer."²⁰ Indeed, even without section 547(c)(7), the section 547(c)(2) ordinary course exception encompasses many consumer debts.²¹ This second rationale, therefore, is concerned with administrative convenience: reducing litigation over small preferences that appear to have been in the ordinary course of business. The two policies of preference law are not implicated by this rationale for section 547(c)(7)'s existence.

The third rationale for section 547(c)(7) is economic efficiency. The argument is that the small preference exception prevents litigation over preferences that are usually not worth recovering: preferences of an amount less than the litigation costs. Further, even if recovery of a preference returns a net gain to the estate, in most cases the recovery contributes nothing to the equal distribution policy because liquidation of the estate generates less than what is needed to pay the priority administrative expenses, leaving nothing for creditors.²²

¹⁹ Countryman, *supra* note 2, at 816-17; Broome, *supra* note 8, at 111; Michael J. Herbert, *Bankcard's Revenge: A Critique of the 1984 Consumer Credit Amendments to the Bankruptcy Code*, 19 U. RICH. L. REV. 845, 847 n.8 (1985).

²⁰ Broome, *supra* note 8, at 122.

²¹ Raymond T. Nimmer, *Consumer Bankruptcy Abuse*, 50 LAW & CONTEMP. PROBS. 89, 107 (1987) (arguing that § 547 "insulates ordinary-course consumer credit behavior from [avoidance]. This scheme creates an opportunity for planning through preferential payment of selected creditors.").

²² S. REP. NO. 446, *supra* note 18, at 24 (1982); *Bankruptcy Reform Act of 1978: Hearings Before the Subcomm. on Courts of the Senate Comm. on the Judiciary, Part I*, 97th Cong., 1st Sess. 51, 51, 68-69, 93 (1981) [hereinafter *1981 Senate Hearings*] (prepared statement of Claude Rice, Alvin O. Wiese, Jr., and Jonathan M. Landers, all of whom were serving as consultants to an organization of consumer lenders).

Two prominent authorities have rejected the economic efficiency rationale. Judge Cyr argued that the \$1,000 cutoff in one particular small preference exception proposal was unrelated to the costs of litigation because the litigation may consist of "no more than a mere demand."²³ Professor Countryman criticized the concept of a small preference exception, arguing that regardless of whether the equal distribution policy was being advanced, it was inappropriate for the Bankruptcy Code to favor a preferential transferee over individuals who were owed administrative costs.²⁴ Moreover, in the cases in which the estate is sufficient to pay something to unsecured creditors, the small preference exception operates to thwart the policy of equal distribution of the estate. If anything, economic efficiency analysis recommends giving the trustee²⁵ unqualified discretion in deciding when to attack a preference. The trustee is in the best position to determine when recovery will be efficient because the trustee, as an officer of the court, owes a fiduciary duty to both the debtor and the creditors.²⁶ Because the trustee necessarily internalizes all the costs of administering the estate, the trustee should decide when to attack a preference.²⁷

Thus, all three rationales for the small preference exception are weak. The next two parts of this Note discuss the ancestors of section 547(c)(7) and how this provision has been and should be interpreted by the courts.

III. LEGISLATIVE HISTORY OF SECTION 547(C)(7)

A recommendation for an overhaul of the Bankruptcy Code came in a 1970 report to Congress by the National Bankruptcy Conference. The report acknowledged suggestions that "smaller transfers made in the ordinary course of business could be immunized from attack under § 60," but it did not specifically recommend a small preference exception.²⁸ The National

²³ Conrad K. Cyr, *Setting the Record Straight for a Comprehensive Revision of the Bankruptcy Act of 1898*, 49 AM. BANKR. L.J. 99, 166 n.242 (1975) (criticizing bankruptcy legislation proposed by the Commission on the Bankruptcy Laws of the United States); see *infra* note 32.

²⁴ Countryman, *supra* note 2, at 814 n.525, 815, 817 (calling small preference exceptions "unjustifiable," "indefensible," and "at war with preference policy").

²⁵ Recovery of preferences by a debtor by way of § 522(h) presents a special issue, that of the bankruptcy policy protecting debtors' exemptions. See *infra* part IV.A.

²⁶ *Germain v. Connecticut Nat'l Bank*, 988 F.2d 1323, 1330 n.8 (2d Cir. 1993); *River Prod., Co. v. Webb (In re Topco, Inc.)*, 894 F.2d 727, 739 n.16 (5th Cir. 1990).

²⁷ Cyr, *supra* note 23, at 166 n.242; Countryman, *supra* note 2, at 814 n.525.

²⁸ NATIONAL BANKRUPTCY CONFERENCE, REPORT OF THE COMMITTEE ON COORDINATION OF THE BANKRUPTCY ACT AND THE UNIFORM COMMERCIAL CODE (1970),

Bankruptcy Conference later recommended a \$500 small preference exception.²⁹

Debate in Congress about an overhaul of the bankruptcy system was based on two proposals for replacing the Bankruptcy Code of 1898: one from the congressionally created Commission on the Bankruptcy Laws of the United States and one from the National Conference of Bankruptcy Judges.³⁰ The legislation proposed by the National Conference of Bankruptcy Judges contained no small preference exception.³¹ The Commission's proposed Bankruptcy Act of 1973 contained a small preference exception of \$1,000:

The trustee may not avoid a transfer under this section if the aggregate value of all property so transferred to a creditor other than a member of the immediate family, a partner, an affiliate, a director, an officer, or a managing agent of or for the debtor, is less than \$1,000.³²

reprinted in H.R. REP. NO. 595, *supra* note 10, at 204, 209, reprinted in 1978 U.S.C.C.A.N. at 6170-71.

²⁹ *Bankruptcy Act Revision: Hearings Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary, House of Representatives, H.R. 31 and H.R. 32, Appendix*, 94th Cong., 1st & 2d Sess. 333, 362 (1976) [hereinafter *Appendix to Hearings*] (proposed Bankruptcy Act of 1975, § 4-607(b)(1), by the National Bankruptcy Conference). The proposed exception would have covered any

transfer to a creditor other than one who at the date the transfer occurred was a member of the immediate family, a partner, an affiliate, a director, an officer, or a managing agent of or for the debtor if the aggregate value of all property so transferred to that creditor is less than \$500.

Id. (mark-up notations omitted). For comments accompanying the proposed exception, see *Bankruptcy Act Revision: Hearings Before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary, House of Representatives, H.R. 31 and H.R. 32, Part 3*, 94th Cong., 2d Sess. 1835, 1841 (1976) (prepared statement of Leon S. Foreman on behalf of the National Bankruptcy Conference).

³⁰ S. REP. NO. 989, 95th Cong., 1st Sess. 1-2 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5787-88, and in COLLIER ON BANKRUPTCY app. 3 (15th ed. 1979) (also containing a summary of the legislative history of the Bankruptcy Reform Act of 1978). For a line-by-line comparison of the two proposals, see *Appendix to Hearings, supra* note 29.

³¹ *Appendix to Hearings, supra* note 29, at 177.

³² REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. II, at 166 (1973) (proposed Bankruptcy Act of 1973, § 4-607(b)(1)), reprinted in COLLIER ON BANKRUPTCY app. 2 at 166 (15th ed. 1979).

This is the most pro-creditor proposal that appears in the legislative history. First, like the current section 547(c)(7), the exception is not conditioned on either a lack of reasonable cause to believe the debtor was insolvent or the transfer having been made within the ordinary course of business. Second, \$1,000 was the highest exception amount proposed. In its commentary accompanying the proposed legislation, the Commission advanced all three rationales for a small preference exception:

Relatively small preferences do not seriously impinge on the goals of equality of treatment, avoidance of the grab-bag effect, and prevention of unwise extension of credit. In addition, the expense of recovery is often disproportionate to the benefit to creditors. . . . This exception is also intended to soften the impact of the Commission's recommendation to abandon the reasonable cause to believe requirement and to impose a presumption of insolvency.³³

The Bankruptcy Reform Act of 1978 contained no small preference exception.³⁴

At Senate hearings in 1981,³⁵ creditors proposed adding a small preference exception to section 547(c). One creditor group proposed legislation that included an exception for any transfer

to the extent that such transfer or transfers involved payments aggregating not more [than] \$750 on a consumer debt or open end credit account, in the ordinary course of financial affairs of the debtor and the transferee and according to ordinary business terms, unless the creditor had reasonable cause to believe the debtor was insolvent.³⁶

The commentary accompanying this proposal claimed the small preference exception was required because the "ordinary course" exception's forty-five day requirement was too restrictive in the consumer credit context.³⁷ This proposal is based on the second rationale, that the small preference exception is an adjunct to the ordinary course exception. This proposed exception is noteworthy for its narrow scope: it would be redundant today because the forty-five day requirement of the section 547(c)(2) ordinary course exception

³³ *Id.* pt. I, at 206 (footnotes omitted); *see also id.* pt. II, at 170 n.11.

³⁴ *See* Pub. L. No. 95-598, 92 Stat. 2549, 2599 (1978).

³⁵ 1981 Senate Hearings, *supra* note 22. The hearings concerned Senate Bill 863, which contained no small preference exception. *Id.* at 319, 363.

³⁶ *Id.* at 72, 92.

³⁷ *Id.* at 92-94; *see also* Countryman, *supra* note 2, at 814 & n.527 (citing same hearings).

was eliminated by the BAFJA at the same time section 547(c)(7) was enacted.³⁸ The commentary also relies on the third rationale in saying that the equal distribution policy is not served by recovery of small preferences because small preferences usually go to pay administration costs, not creditors.³⁹

During the same 1981 Senate hearings, the American Retail Federation recommended excepting all payments on consumer debts in the ordinary course of business, or alternatively at least \$750 of such payments.⁴⁰ The National Association of Federal Credit Unions⁴¹ and the Credit Union National Association⁴² urged Congress to except all ordinary course payments on consumer installment debt when the creditor did not have reason to know of the debtor's insolvency. The groups argued that unknowing creditors would not pressure debtors and that the small amounts involved in such debt payments made a negligible contribution to the equal distribution policy. By 1982, the consumer creditors' lobby had convinced the Senate Judiciary Committee that the trustee's preference power was too great under the 1978 Act.⁴³

A bill introduced in 1983 by Representative Rodino, Chairman of the House Judiciary Committee, contained an unqualified small preference exception applicable to all debtors in Chapters 7, 11, or 13 regardless of the creditor's state of mind or whether the transfer occurred in the ordinary course. The exception would have protected any transfer

if the aggregate value of all property that constitutes or is affected by such transfer—

(A) in a case under chapter 7 or 13 of this title is less than \$250; and

(B) in a case under chapter 11 of this title is less than \$750.⁴⁴

The Judiciary Committee did not act on the bill.

In 1984 the language of the current section 547(c)(7) appeared in the original version of House Bill 5174,⁴⁵ which was passed by the House on

³⁸ Pub. L. No. 98-353, § 462(c), 98 Stat. 333, 378 (1984); *see also* Countryman, *supra* note 2, at 814 & n.528.

³⁹ 1981 Senate Hearings, *supra* note 22, at 93.

⁴⁰ *Id.* at 153, 158 (prepared statement of Bud Grant on behalf of the American Retail Federation).

⁴¹ *Id.* at 168, 171-72 (prepared statement of Fred M. Haden on behalf of the National Association of Federal Credit Unions).

⁴² *Id.* at 174, 181-82 (prepared statement of Eldon Hoekstra on behalf of the Credit Union National Association).

⁴³ *See supra* note 18 and accompanying text.

⁴⁴ H.R. 1147, 98th Cong., 1st Sess. § 9(3) (1983).

March 21, 1984.⁴⁶ Disagreements between the House and Senate resulted in a modified version of the bill, which did not alter the small preference exception.⁴⁷

To the extent one can say there was an evolution in the development of section 547(c)(7), it was an evolution to the benefit of creditors, because section 547(c)(7) provides creditors with more protection than would have been provided by most of the other proposals Congress considered, the exception being that of the Commission on the Bankruptcy Laws of the United States.⁴⁸ Section 547(c)(7) protects more than merely payments made in the ordinary course of the debtor's financial affairs,⁴⁹ and it protects transfers even if the creditor knew that the debtor was insolvent and that bankruptcy was imminent.⁵⁰ Although the legislative history indicates that section 547(c)(7) was designed to benefit consumer creditors, section 547(c)(7) does not protect every \$600 payment on consumer debts. Rather, it protects every \$600 transfer, whether or not it pertains to a consumer debt, made by "an individual whose debts are primarily consumer debts."⁵¹ The significance, if any, of this distinction is not apparent from the legislative history or the cases. The language is identical to that in section 707(b), regarding dismissal of a Chapter 7 case.

Finding cogent reasons in the legislative history upon which to base decisions in section 547(c)(7) cases is difficult. Few cases have cited legislative history or even based decisions on the supposed rationales for section

⁴⁵ H.R. 5174, 98th Cong., 2d Sess. § 210 (1984), *reprinted in* 130 CONG. REC. 6226, 6235 (1984).

⁴⁶ 130 CONG. REC. 6249 (1984).

⁴⁷ Broome, *supra* note 8, at 111. For a detailed analysis of the legislative history of BAFJA, see *id.* at 99–112.

⁴⁸ See *supra* note 32 and accompanying text.

⁴⁹ Morris, *supra* note 10, at 121. Professor Countryman argues:

With the 1984 elimination of the forty-five day limit in section 547(c)(2), the consumer credit industry now has it both ways. For all consumer payments of less than \$600, the industry does not have to worry about the "ordinary course of business" limitation in section 547(c)(2). Moreover, because section 547(c)(7), unlike section 547(c)(2), is not confined to "payments" but applies to any transfer, consumer creditors now have a \$600 exception from section 547 for all consumer-credit security interests.

Countryman, *supra* note 2, at 814 (footnotes omitted).

⁵⁰ Morris, *supra* note 10, at 121–22.

⁵¹ 11 U.S.C. § 547(c)(7) (1988).

547(c)(7).⁵² Therefore, the best way to analyze section 547(c)(7) cases is in terms of the two policies of preference law.

IV. ISSUES OF INTERPRETATION

A survey of the cases interpreting section 547(c)(7) raises six issues, each of which is discussed below.

A. Should Section 547(c)(7) Apply Equally to Trustees and Debtors Who Are Attempting to Avoid a Preference?

By itself, section 547(b) allows only the trustee, not the debtor, to recover preferences.⁵³ The difference between recovery by the trustee and recovery by the debtor is that property recovered by the trustee becomes part of the estate to be distributed to creditors, while property recovered by the debtor pursuant to an exemption belongs to the debtor free and clear of any claims of creditors or the trustee. Although debtors in Chapter 11 or Chapter 13 cases can wield most of the powers of a trustee,⁵⁴ there is no similar provision empowering Chapter 7 debtors. The Chapter 7 debtor's power to avoid a transfer, preferential or otherwise, derives from section 522(h) and is limited to the avoidance power of the trustee.⁵⁵ Section 522(h) provides:

The debtor may avoid a transfer of property of the debtor or recover a setoff to the extent that the debtor could have exempted such property under subsection (g)(1) of this section if the trustee had avoided such transfer, if—

⁵² *CHG Int'l, Inc. v. Barclays Bank (In re CHG Int'l, Inc.)*, 897 F.2d 1479, 1484 & n.8 (9th Cir. 1990) (lamenting dearth of legislative history and relying on the rationale that § 547(c)(7) was designed as an adjunct to the ordinary course exception); *Ragsdale v. Citizens & S. Nat'l Bank (In re Control Elec.)*, 91 B.R. 1010, 1013-14 (Bankr. N.D. Ga. 1988) (relying on the "ordinary course" and the "economic efficiency" rationales); *Johnson v. Ford Motor Credit Co. (In re Johnson)*, 53 B.R. 919, 921 (Bankr. N.D. Ill. 1985) (choosing "plain language" interpretation over perceived legislative intent regarding application of § 547(c)(7) to debtors), *adhered to*, 57 B.R. 635 (1986).

⁵³ Section 547(b) reads: "The trustee may avoid . . ." 11 U.S.C. § 547(b) (1988) (emphasis added).

⁵⁴ 11 U.S.C. §§ 1107(a), 1303 (1988).

⁵⁵ *Via v. Colonial Am. Nat'l Bank (In re Via)*, 107 B.R. 91, 93 (Bankr. W.D. Va. 1989); *Kentucky Fin., Inc. v. Newell (In re Newell)*, 71 B.R. 672, 674 (Bankr. M.D. Ga. 1987); *Harville v. Morris (In re Harville)*, 60 B.R. 188, 189 (Bankr. W.D. Ky. 1986); *Johnson*, 53 B.R. at 921; *Holyfield v. Knopp (In re Holyfield)*, 50 B.R. 695, 697 (Bankr. D. Md. 1985).

- (1) such transfer is avoidable by the trustee under section . . . 547 . . . ; and
- (2) the trustee does not attempt to avoid such transfer.⁵⁶

Section 522(g)(1) provides:

[T]he debtor may exempt under subsection (b) of this section property that the trustee recovers . . . to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if—

- (1)(A) such transfer was not a voluntary transfer of such property by the debtor; and
- (B) the debtor did not conceal such property⁵⁷

In other words, the debtor may recover the property as an exemption if all five of these conditions are satisfied: (1) the property would be exempt under section 522(b), (2) the transfer is avoidable, (3) the transfer was involuntary, (4) the trustee did not attempt to avoid the transfer, and (5) the debtor did not conceal the property.

Section 522(h) thus produces this undesirable result: property that a debtor could otherwise recover as exempt under section 522(h) may not be recovered if the transfer of the property is within the section 547(c)(7) exception. The reason is that the requirement of section 522(h)(1) is not met: the transfer is not “avoidable by the trustee under section 547,”⁵⁸ because the transfer is protected by the section 547(c)(7) exception. This result is undesirable because the Bankruptcy Code’s fresh start policy includes zealous protection of the debtor’s exemptions.⁵⁹

Whatever the legislative intent as perceived by the courts, they have unanimously—albeit reluctantly—upheld the literal operation of section 522(h) and prevented debtors from recovering preferences of less than \$600.⁶⁰ In

⁵⁶ 11 U.S.C. § 522(h) (1988).

⁵⁷ *Id.* § 522(g).

⁵⁸ *Id.* § 522(h)(1).

⁵⁹ *In re Barker*, 768 F.2d 191, 196 (7th Cir. 1985); *In re Keyworth*, 47 B.R. 966, 972 (Bankr. D. Colo. 1985); *Johnson*, 53 B.R. at 921. *In re Ancira*, 5 B.R. 673, 674 (Bankr. N.D. Cal. 1980).

⁶⁰ However, debtors have succeeded in getting around the § 547(c)(7) exception by using § 522(f)(1) to recover garnished wages not yet paid to the creditor by the employer. Section 522(f)(1) provides that the debtor may avoid a judicial lien to the extent the lien “impairs” a § 522(b) exemption. Whether wage garnishment creates a lien is a matter of state law; typically, it does. *In re Yetter*, 112 B.R. 301, 302 (Bankr. S.D. Iowa 1990); *Holdway v. Duvoisin* (*In re Holdway*), 83 B.R. 510, 513 n.7 (Bankr. E.D. Tenn. 1988); *In re Keinath*, 102 B.R. 699, 702 (Bankr. C.D. Ill. 1986); *Harville v. Morris* (*In re Harville*),

*Holyfield v. Knopp (In re Holyfield)*⁶¹ the court blocked the debtor from recovering \$466 of garnished wages. The court viewed this result as undesirable because it prevented the debtor from making full use of the debtor's exemptions, thus hindering the debtor's fresh start.⁶² Similarly, the court in *Johnson v. Ford Motor Credit Co. (In re Johnson)*⁶³ blocked the debtor from recovering \$204 of garnished wages. The court acknowledged the inconsistency of its action with the fresh start policy and questioned the wisdom of the expansive language of section 547(c)(7):

Although we think that Congress directed § 547(c)(7) at trustees proceeding under § 547 rather than debtors asserting exemption rights and proceeding under § 522(h), the broad language of § 547(c)(7) is clear and applies to all proceedings under § 547 regardless of who is bringing them and regardless of whether the property to be recovered will be exempt or not.⁶⁴

60 B.R. 188, 190 (Bankr. W.D. Ky. 1986), 63 B.R. 371, 372; *Johnson*, 53 B.R. at 922; 4 COLLIER ON BANKRUPTCY ¶ 67.10, at 132-33 (14th ed. 1967). The typical wildcard exemption allows the debtor to exempt any property up to a certain amount, and the wildcard exemption may be used as the exemption "impaired" by the wage garnishment. *In re Smith*, 640 F.2d 888, 891 (7th Cir. 1981); *Johnson*, 53 B.R. at 923. In both *Smith* (in which the debtor used the § 522(d)(5) wildcard) and *Johnson* (in which the debtor used the state wildcard), creditors unsuccessfully argued that wildcard exemptions should be applied only to other property specifically exempted by the exemption statute. Thus, even if the amount of garnished wages is less than \$600, the debtor can recover the wages under § 522(f)(1) by asserting that the garnishment is impairing the wildcard exemption.

The courts have addressed this issue in detail. The creditor does not have an unconditional right to the garnished wages until they are paid or, as in Illinois, until the court issues a second order, a wage deduction order. *Johnson*, 53 B.R. at 923. The judicial lien is extinguished (and § 522(f)(1) rendered inapplicable) as to a portion of wages when those wages are paid to the judgment creditor. *Buzzell v. Montgomery Ward & Co. (In re Buzzell)*, 56 B.R. 197, 198 (Bankr. D. Md. 1986). However, when a second court order is required before the garnishee may pay the garnished amount to the garnisher, yet the garnishee pays before the second court order is issued, the judgment lien on those wages is not extinguished. *Keinath*, 102 B.R. at 701. Section 522(f)(1) does not apply to wage assignments because wage assignment does not create a judicial lien. *In re Rosol*, 114 B.R. 560, 564 (Bankr. N.D. Ill. 1989).

⁶¹ 50 B.R. 695 (Bankr. D. Md. 1985).

⁶² *Id.* at 697.

⁶³ 53 B.R. 919, 921 (Bankr. N.D. Ill. 1985).

⁶⁴ *Id.* (footnote omitted).

All three of the other cases deciding this issue have followed *Holyfield* and *Johnson*.⁶⁵ As these court opinions suggest, because of the strong policy to protect exemptions and because section 522(h) predates section 547(c)(7), it is doubtful that the drafters of section 547(c)(7) intended to restrict debtors' exemptions.

Given the unwillingness of the courts to interfere with the literal operation of section 522(h) in this context, how should the Bankruptcy Code be modified? The court in *Holyfield* asserted that Congress probably intended that section 547(c)(7) should protect only voluntary transfers⁶⁶ because section 522(h), by way of section 522(g)(1)(A), allows the debtor to recover only involuntary transfers. However, reducing the scope of section 547(c)(7) to protect only voluntary transfers goes too far. Because the sole aim of the modification would be to protect the debtor's exemption rights, involuntary transfers should be outside of the section 547(c)(7) exception only when it is the debtor that is seeking to recover the preference under section 522(h). As to the trustee's attempt to recover preferences under section 547, there is no reason for distinguishing between voluntary and involuntary transfers. The voluntary-involuntary distinction arises from section 522(g)(1), which is applicable only when it is the debtor who is seeking to recover.⁶⁷ Indeed, the court in *Johnson* suggested that section 547(c)(7) was intended as a limitation on trustees only.⁶⁸ Thus, the better modification to the Bankruptcy Code would be one that merely prevented creditors from using section 547(c)(7) to protect an involuntary preference when the debtor seeks to avoid it under section 522(h). The best means of accomplishing this result would be to renumber section 547(c)(7) as 547(c)(7)(A) and add as section 547(c)(7)(B):

Subparagraph (A) of this paragraph shall not apply so as to prevent a debtor from avoiding a transfer under section 522(h) of this title.

⁶⁵ *McDaniel v. Nationwide (In re McDaniel)*, 85 B.R. 69, 71 (Bankr. N.D. Ill. 1988); *Kentucky Fin., Inc. v. Newell (In re Newell)*, 71 B.R. 672, 674 (Bankr. M.D. Ga. 1987); *Harville v. Morris (In re Harville)*, 60 B.R. 188, 189-90 (Bankr. W.D. Ky. 1986).

⁶⁶ *Holyfield v. Knopp (In re Holyfield)*, 50 B.R. 695, 697 (Bankr. D. Md. 1985).

⁶⁷ Of course, a greater restriction on the section 547(c)(7) exception would advance the policy of equal distribution of the debtor's assets, but the same could be said about restricting any of the section 547(c) exceptions. *Ray v. Cannon's, Inc. (In re Vickery)*, 63 B.R. 222, 223 (Bankr. E.D. Tenn. 1986).

⁶⁸ *Johnson v. Ford Motor Credit Co. (In re Johnson)*, 53 B.R. 919, 921 n.4 (Bankr. N.D. Ill. 1985), *adhered to*, 57 B.R. 635 (1986). However, the court admitted that nowhere in the legislative history was a distinction explicitly made between recovery by the trustee and recovery by the debtor. The court said § 547(c)(7) was inspired by *Barash v. Public Finance Corp.*, 658 F.2d 504 (7th Cir. 1981), a consolidated case in which the trustees recovered several small preferences.

B. *The Meaning of "Transfer": Single Transfer or Aggregation of Transfers?*

Section 547(c)(7) provides: "The trustee may not avoid under this section a transfer if . . . the aggregate value of all property that constitutes or is affected by such transfer is less than \$600."⁶⁹ Section 101(54)⁷⁰ defines transfer as "every mode" of disposing of property, but there does not appear to be any case expressly holding that, as defined under section 101, multiple, discrete transfers might constitute one transfer. Nevertheless, every court that has addressed the issue of what constitutes a transfer within the meaning of section 547(c)(7) has interpreted transfer to include all transfers made to a single creditor during the preference period.⁷¹ Although the early commentators on section 547(c)(7) questioned whether this "aggregation" interpretation would or should prevail, it is the better interpretation.

The first court opinion to discuss the aggregation issue in detail came in the 1992 case of *In re Bunner*,⁷² in which the court reached the proper result by unpersuasive reasoning. In *Bunner*, the debtor sought to recover \$1,033, which had been paid to a creditor in two payments made two months apart, but both within the ninety-day preference period. Each payment met the section 547(b) requirements for a preference, but each payment was less than \$600. The court held that the debtor could recover the payments: the two payments fell outside

⁶⁹ 11 U.S.C. § 547(c)(7) (1988).

⁷⁰ This subsection of the Code has been erroneously numbered and probably should be numbered § 101(58).

⁷¹ *In re Bunner*, 145 B.R. 266, 266-67 (Bankr. C.D. Ill. 1992) (allowing the debtor to recover \$1,033, which had been paid to a single creditor in two payments made within the preference period); *Lewis v. State Employees Credit Union (In re Lewis)*, 116 B.R. 54, 57 (Bankr. D. Md. 1990) (allowing debtor to recover \$847 of garnished wages, which had been paid to a single creditor in three payments, each less than \$600, over the course of seven weeks); *In re Irvine*, 95 B.R. 464, 465 (Bankr. W.D. Ky. 1988) (denying debtor from recovering \$680 of garnished wages because each of three creditors received less than \$600). Two other decisions have approved of the aggregation interpretation in dicta. *In re Passmore*, 156 B.R. 595, 598 (Bankr. E.D. Wis. 1993) (citing *Bunner* with approval but denying debtor from recovering because payments totaled less than \$600); *Holdway v. Duvoisin (In re Holdway)*, 83 B.R. 510, 515 (Bankr. E.D. Tenn. 1988) (approving of aggregation interpretation but denying debtor from recovering because payments totaled less than \$600).

The "preference period" is the 90-day or one-year period preceding the bankruptcy. Under § 547(b)(4), one of the requirements of a preference is that it have been made on or within 90 days before the filing of the bankruptcy petition, or within one year if the creditor is an insider.

⁷² 145 B.R. 266 (Bankr. C.D. Ill. 1992).

of the section 547(c)(7) exception because they constituted one transfer within the meaning of section 547(c)(7), and that transfer was for more than \$600.⁷³ The court reasoned that "the plain language of section 547(c)(7) mandates that both transfers be added together in determining whether the minimum of \$600 has been met. . . . Any other interpretation of the statute would render the 'aggregate' language meaningless."⁷⁴

The court's reasoning is incorrect on both counts. The plain language of section 547(c)(7) is transfer in the singular. Indeed, prior to most of the case law interpreting section 547(c)(7), commentators, plus one court in dicta, suggested that the single transfer interpretation was mandated by the language of section 547(c)(7).⁷⁵ Said the court in *Ray v. Cannon's, Inc. (In re Vickery)*: "The answer is not clear. . . . [Section 547(c)(7)] appears to be unlimited as to the total amount of preferential payments that are protected so long as each is less than \$600."⁷⁶ Moreover, Congress had considered a precise small preference exception in 1981 that clearly incorporated an aggregation rule: the Rice-Wiese-Landers proposal excepted preferences "to the extent that such transfer or transfers involved payments aggregating not more [than] \$750."⁷⁷ Thus, the *Bunner* court is unconvincing in arguing that the "plain language" of section 547(c)(7) mandates that transfer include all transfers made during the preference period.

The court in *Bunner* is also wrong in arguing that a single transfer interpretation would render the word "aggregate" in the statute meaningless. The phrase in section 547(c)(7) is: "the aggregate value of all property that constitutes . . . such transfer."⁷⁸ The use of the expansive term "all property" contemplates a transfer of other than cash, such as other tangible property or a security interest.⁷⁹ Aggregate, therefore, should be interpreted as referring to the aggregation of the cash and noncash components of a transfer, the definition of which is a separate issue.

Rather than the two reasons offered in *Bunner*, there are three other reasons for preferring an "aggregation rule" over a "single transfer" interpretation of section 547(c)(7). First, a single transfer interpretation would

⁷³ *Id.* at 266.

⁷⁴ *Id.* at 266-67.

⁷⁵ Morris, *supra* note 10, at 119-20; Richard F. Duncan, *Loan Payments to Secured Creditors as Preferences Under the 1984 Bankruptcy Amendments*, 64 NEB. L. REV. 83, 87-88 (1985); *Ray v. Cannon's, Inc. (In re Vickery)*, 63 B.R. 222, 224 (Bankr. E.D. Tenn. 1986) (allowing trustee to recover a \$957 payment).

⁷⁶ *Ray*, 63 B.R. at 224.

⁷⁷ 1981 Senate Hearings, *supra* note 22, at 92 (emphasis added).

⁷⁸ 11 U.S.C. § 547(c)(7) (1988).

⁷⁹ Morris, *supra* note 10, at 119-20.

violate the second policy of preferences by encouraging creditors to pressure the debtor: a creditor would pressure a desperate debtor into paying the creditor in discrete transfers of less than \$600 each.⁸⁰ Furthermore, discouraging such strategic transfers is consistent with the broad definition transfer is accorded in the context of preferences. In the 1977 case *Katz v. First National Bank*,⁸¹ the Second Circuit Court of Appeals said that the Bankruptcy Code's definition of "transfer"

is meant to preclude ingenious methods of circumvention:

All technicality and narrowness of meaning is precluded. The word is used in its most comprehensive sense, and is intended to include every means and manner by which property can pass from the ownership and possession of another, and by which the result forbidden by the statute may be accomplished.⁸²

Strategic transfers being within the ambit of "ingenious methods," precedent supports the aggregation rule interpretation of section 547(c)(7).

The second reason for preferring an aggregation rule is that a single transfer interpretation could cause the result of a case to turn on the acts of third parties. When a series of transfers is made to a creditor by a garnishee-employer pursuant to a wage garnishment order, the garnishee-employer or a court controls how much in garnished wages accumulates before money is paid over to the creditor. The single transfer interpretation would thus create the undesirable situation of the garnishee or the court determining to what extent otherwise preferential transfers could be recovered. In *Bunner*, for example, the debtor's wages had been garnished at the rate of \$67 per week, and the employer had made two payments, each about \$520, to the creditor.⁸³ Pursuant to Illinois law, each payment was made pursuant to a second court order. The court adopted the aggregation rule interpretation, so the transfer was \$1,040, outside of the section 547(c)(7) exception. Under a single transfer interpretation, however, there would have been different results depending on whether the court had delayed its order two weeks as to either of the payments, time enough for the garnished funds to accumulate from \$520 to more than \$600.

Third, an aggregation rule interpretation of section 547(c)(7) is better because it decreases its applicability, thereby increasing the avoidability of

⁸⁰ *Id.* at 120.

⁸¹ 568 F.2d 964 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

⁸² *Id.* at 969 n.4 (quoting *Pirie v. Chicago Title & Trust Co.*, 182 U.S. 438, 444 (1901)).

⁸³ *In re Bunner*, 145 B.R. 266, 266 (Bankr. C.D. Ill. 1992).

preferences. When the debtor recovers a preference under section 522(h), the recovery is in the nature of an exemption, and exemptions are favored by bankruptcy policy.⁸⁴ Thus, there is a policy argument for interpreting section 547(c)(7) to favor debtors over creditors, if not trustees over creditors, when determining the scope of section 547(c)(7).

But is it appropriate to categorically deem as one avoidable transfer two unrelated \$300 transfers made up to eighty-nine days apart in the ordinary course of the debtor's financial affairs? Such transfers are, at the very least, barely outside the set of preferences Congress intended to protect under section 547(c)(7). In litigating the meaning of "transfer," debtors and trustees have failed to reduce that set much further. For example, if there are two payments to the same creditor, less than \$600 individually but more than \$600 together, and if only one of the payments falls within the ninety-day preference period, the payments are not aggregated, and the second payment falls within the section 547(c)(7) exception.⁸⁵ Nor does transfer include the aggregation of transfers made to multiple creditors: each creditor may assert its rights under section 547(c)(7) fully and independently.⁸⁶ However, the scope of the exception is reduced by the holding that the portion of a preferential debt payment attributable to accrued interest on the debt is part of the same transfer.⁸⁷

C. What Does "Property Affected By" Mean?

The most curious language in section 547(c)(7) is "property affected by": "The trustee may not avoid . . . a transfer . . . if . . . the aggregate value of all property that constitutes *or is affected by* such transfer is less than \$600."⁸⁸ The origin of this phrase appears to be House Bill 1147, a bankruptcy bill that never made it out of the Judiciary Committee.⁸⁹ Because both House Bill 1147 and House Bill 5174, which became BAFJA, were sponsored by Judiciary Committee Chairman Rodino, it is possible that the phrase was casually incorporated into House Bill 5174 and never considered again.

⁸⁴ See *supra* part IV.A.

⁸⁵ *Howes v. Hannibal Clinic (In re Howes)*, 165 B.R. 270 (Bankr. E.D. Mo. 1994).

⁸⁶ *In re Irvine*, 95 B.R. 464, 465 (Bankr. W.D. Ky. 1988) (denying debtor from recovering \$680 of garnished wages because each of three creditors received less than \$600); *In re Figueira*, 163 B.R. 192, 195 (Bankr. D. Kan. 1993) (dicta).

⁸⁷ *Covey v. Pottery Workers Credit Union (In re Rogers)*, 127 B.R. 844, 848 (C.D. Ill. 1989) (denying trustee from recovering a \$925 payment, \$369 of which was attributable to accrued interest).

⁸⁸ 11 U.S.C. § 547(c)(7) (1988).

⁸⁹ See *supra* note 44 and accompanying text.

What does it mean to say property "is affected by" the transfer of other property? It is perhaps a measure of the collective confusion that no reported case refers to any party alleging property has or has not been affected by the transfer of other property. The issue has not gone completely unnoticed, however. In *In re Shorts*,⁹⁰ the court questioned whether the amount at stake in the case should be deemed to be the \$325 garnished during the ninety-day preference period or the total amount that was garnished prior to the filing of the bankruptcy petition. The court did not rule on the issue, however, and instead granted the debtor's motion by default.⁹¹ Collier presumes that the phrase "affected by" has no meaning.⁹²

One's inclination is to dismiss the phrase as a redundancy typical of legal writing. The lack of case law suggests that this dismissal is precisely what litigants have done. But trustees and debtors may be ignoring a potential boon: an expansive interpretation of "affected by" would bring a transfer outside of the section 547(c)(7) exception whenever the trustee or debtor could show that property worth more than \$600 has been affected. A credible basis for giving at least some meaning to the phrase "affected by" is that Congress considered several small preference exceptions,⁹³ yet the phrase appeared in only House Bill 1147 and House Bill 5174, the bill that was enacted as BAFJA. Given the difficulty adjudicating when property is affected by a transfer, however, it is likely that the phrase will continue to be meaningless. Congress should delete it or define it.

D. Is Section 547(c)(7) Subject to a Different Burden of Proof?

The burden of proof as to preference issues is set forth in section 547(g), which says that the trustee has the burden of proving avoidability under section 547(b) and that the creditor has the burden of proving an exception under section 547(c).⁹⁴ Nevertheless, the court in *McDaniel v. Nationwide (In re*

⁹⁰ 63 B.R. 2, 4 (Bankr. D.D.C. 1985).

⁹¹ *Id.* at 4.

⁹² "Under section 547(c)(7), there is no preference if *the value of the interest transferred* by a debtor whose debts are primarily consumer debts is less than \$600." 4 COLLIER ON BANKRUPTCY ¶ 547.15 (15th ed. 1979) (emphasis added).

⁹³ See *supra* part III.

⁹⁴ Section 547(g) provides:

For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

McDaniel)⁹⁵ expressly refused to enforce the burden of proof set forth in section 547(g) as it applied in a section 547(c)(7) case. In denying the debtor default judgment even though the creditor had not filed an answer, the court reasoned that creditors should not be penalized for failing to answer "complaints [that] evidence a defense under section 547(c)(7)."⁹⁶ Because preferential transfers allowed under section 547(c)(7) are so small, the court said, "the Congressional decision that small preferences should remain undisturbed would be undercut by the economic reality that small cases are often not worth defending."⁹⁷ The court said that when the preference is less than \$600, it is the movant trustee or debtor that must adduce evidence that the debts are not primarily consumer debts. "This procedure does shift the burden of proof on an affirmative defense to the plaintiff. But the facts required—the nature of the debtor's debts—should be within the plaintiff's knowledge if the plaintiff is the debtor, or, if the plaintiff is a trustee, readily ascertainable."⁹⁸

Thus, the court refused to enforce the statutory burden of proof based on the administrative convenience rationale for section 547(c)(7). Even one who subscribes to this rationale must find some irony in the fact that in this antidebtor decision the court bluntly refuses to enforce the statute, yet courts have uniformly adhered to the statute in forbidding debtors to avoid transfers under section 522(h).⁹⁹

E. What Does "Primarily Consumer Debts" Mean?

The section 547(c)(7) exception applies only "in a case filed by an individual debtor whose debts are primarily consumer debts."¹⁰⁰ Two questions arise: what is a "consumer debt," and what does "primarily" mean?¹⁰¹

"Consumer debt" is defined in section 101(8) as "debt incurred by an individual primarily for a personal, family, or household purpose."¹⁰² "The definition is adapted from the definition used in various consumer protection

11 U.S.C. § 547(g) (1988).

⁹⁵ 85 B.R. 69 (Bankr. N.D. Ill. 1988).

⁹⁶ *Id.* at 71.

⁹⁷ *Id.* at 71–72.

⁹⁸ *Id.* at 72.

⁹⁹ See *supra* part IV.A.

¹⁰⁰ 11 U.S.C. § 547(c)(7) (1988). It is irrelevant whether the transfer at issue relates to a consumer debt. THOMAS D. CRANDALL ET AL., *THE LAW OF DEBTORS AND CREDITORS* ¶ 16.04[7][g], at 16–59 (rev. ed. 1991).

¹⁰¹ See generally 4 COLLIER ON BANKRUPTCY ¶ 707.06 (15th ed. 1993).

¹⁰² 11 U.S.C. § 101(8) (1988).

laws."¹⁰³ The Ninth Circuit Court of Appeals, in *Zolg v. Kelly* (*In re Kelly*),¹⁰⁴ held that the purpose of the debt is determinative of whether the debt is a consumer debt. Consumer debts have been described as all nonbusiness debts one would ordinarily expect to incur in one's daily affairs.¹⁰⁵ It has also been held that a consumer debt must have been acquired primarily to achieve a personal aim or objective.¹⁰⁶

Perhaps the most interesting case on the bankruptcy definition of consumer debt is *In re White*,¹⁰⁷ in which a bankruptcy court held that a tort judgment against an individual debtor is not a consumer debt. Because this result appears to benefit tortfeasors inappropriately by rendering section 547(c)(7) inapplicable, Congress should change section 547(c)(7) from applying when "consumer" debts exceed "nonconsumer" debts to applying when "consumer" debts exceed "business" debts.¹⁰⁸ Such a modification makes sense on its own terms, but if one rejects the three rationales for section 547(c)(7), one must also consider whether there is any reason why a small preference exception should distinguish at all between consumer debtors and business debtors.¹⁰⁹

The most significant application of the consumer debt definition in the context of section 547(c)(7) is to home mortgages. The courts have split on the issue, but the majority of the cases, both recently and overall, hold that debts secured by real property may be consumer debts.¹¹⁰ The minority rule is based primarily on the legislative history of section 101(8), which states that "consumer debt does not include a debt to any extent the debt is secured by real property."¹¹¹ However, there is paramount authority in the Bankruptcy Code itself: sections 524(c)(6)(B) and 524(d)(2) refer to "consumer debt

¹⁰³ S. REP. NO. 989, *supra* note 30, at 22 (1978), *reprinted in* 1978 U.S.C.C.A.N. at 5808.

¹⁰⁴ 841 F.2d 908, 912 (9th Cir. 1988).

¹⁰⁵ *In re Walton*, 69 B.R. 150, 153 (E.D. Mo. 1986), *aff'd*, 866 F.2d 981 (8th Cir. 1989).

¹⁰⁶ *In re White*, 49 B.R. 869, 872 (Bankr. W.D.N.C. 1985).

¹⁰⁷ *Id.* at 872-73.

¹⁰⁸ *Morris*, *supra* note 10, at 118 n.123.

¹⁰⁹ The small preference exception proposed by Rep. Rodino's House Bill 1147 would have applied to both consumer and business debtors. *See supra* note 44 and accompanying text.

¹¹⁰ For a list of cases on both sides of this issue, see *In re Johnson*, 115 B.R. 159, 161-62 (Bankr. S.D. Ill. 1990) (citing with approval *Zolg v. Kelly* (*In re Kelly*), 841 F.2d 908, 912-13 (9th Cir. 1988) and holding that consumer debt may be secured by real property). A recent case holding that debts secured by real property are not consumer debts is *In re Rosta*, 76 B.R. 728, 734 (Bankr. D.S.D. 1987).

¹¹¹ 124 CONG. REC. 32,393 (1978) (statement of Rep. Edwards).

secured by real property.”¹¹² The majority rule is bad for debtors when it comes to section 547(c)(7) because the rule increases the likelihood that the debtor will have “primarily consumer debts,” making the section 547(c)(7) exception available to creditors.

The second issue concerning the meaning of “primarily consumer debts” is the meaning of “primarily.” No court has ruled on the meaning of “primarily” in a section 547(c)(7) case, but the phrase “primarily consumer debts” also appears in section 707(b), regarding dismissal of a Chapter 7 case, and in *Kelly*¹¹³ the Ninth Circuit Court of Appeals held that “primarily” means more than half of the total dollar amount of debts. However, a bankruptcy court in *In re Restea*, a case which also followed the minority rule that consumer debt does not include debt secured by real property, held that “[w]hat constitutes ‘primarily’ for Section 707(b) purposes defies precise definition,” but also held that it was more than fifty-three percent.¹¹⁴

F. Does Section 547(c)(7) Protect Only Transfers of Less Than \$600, or Does It Protect \$600 of Every Preference Regardless of Amount?

Both courts that have considered this issue have held that section 547(c)(7) protects only transfers of less than \$600. In *Ray v. Cannon's, Inc. (In re Vickery)*,¹¹⁵ the court rejected the creditor's argument that section 547(c)(7) entitled the creditor to keep \$599.99 of a \$957 preference. The court cited at least four distinct reasons.

First and most persuasive, if Congress had intended to protect \$599.99 of every such transfer, it would have used the phrase, “to the extent,” which is used in the first five preference exceptions, section 547(c)(1) through (c)(5).¹¹⁶ Second, the statute as interpreted by the court discourages the trustee from attempting to avoid preferences so small as to not be justified by the litigation costs.¹¹⁷ This “economic efficiency” justification is weak because economic efficiency is better determined by the trustee or the debtor than by a per se rule.¹¹⁸ Third, were the creditor's interpretation to be adopted, the effect would be to protect transfers of more than \$600.¹¹⁹ Because of the litigation costs, the trustee would be discouraged from attempting to recover preferences

¹¹² *Kelly*, 841 F.2d at 912.

¹¹³ *Id.* at 913.

¹¹⁴ 76 B.R. 728, 734 (Bankr. D.S.D. 1987).

¹¹⁵ 63 B.R. 222 (Bankr. E.D. Tenn. 1986).

¹¹⁶ *Id.* at 223.

¹¹⁷ *Id.*

¹¹⁸ See *supra* text accompanying notes 25-27.

¹¹⁹ *Ray*, 63 B.R. at 223.

marginally greater than \$600, in effect protecting a transfer of more than \$600.¹²⁰ Arguments regarding section 547(c)(7) that are based on litigation costs have been criticized because, with amounts so small at stake, the preferences are less likely to be contested, and even if they are, simple motions might suffice.¹²¹ Fourth, the court speculated that its interpretation "should in the long run allow more recoveries by trustees and lessen the exception's adverse impact on the equal-distribution policy."¹²²

The same result was reached in *Via v. Colonial American National Bank (In re Via)*,¹²³ in which the court relied on *Vickery* and the "obvious reading" and "clear wording" of the statute.¹²⁴

V. CONCLUSION

Preference law is based on two policies, equality in the distribution of the debtor's assets and preventing creditors from pressuring debtors into making transfers. The legislative history of the small preference exception, section 547(c)(7), reveals little more than this: the statute is more the result of effective lobbying by consumer lenders than it is the result of an attempt to promote these preference policies. Congress has left the courts to interpret the statute using only these twin policies, which the statute itself seemingly ignores.

¹²⁰ *Id.*

¹²¹ *See supra* text accompanying note 23.

¹²² *Ray*, 63 B.R. at 223.

¹²³ 107 B.R. 91, 95 (Bankr. W.D. Va. 1989) (denying debtor from recovering a \$779 transfer).

¹²⁴ *Id.*; *see also* *Morris*, *supra* note 10, at 120.